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Where Theory Meets Practice:
CEOs' Choice of Words Matters

The latest presidential election is an outstanding case study of the power of the spoken word. Many thought Donald Trump had no chance of winning the election; indeed, some believed that Hillary Clinton would win in a landslide. Trump is a master of words. He kept saying "Hillary is a crook," "I will drain the swamp in Washington," and "I'm going to make America great again!" This is not an article about politics; rather, it's about the power of communication. *What a leader says matters…a lot!* It seems that the more often Trump repeated his many catchphrases, the more people believed him.

My colleague, Joe Blake, and I both started teaching at the college level about 10 years ago. We occasionally have friendly debates about the dubious value of academic research. I agree with him that much of the research coming from the ivory towers of academia seems pointless. But not all of it is. What I do respect about academic research is that it often serves to either substantiate or disprove conclusions practitioners might draw from anecdotal experiences. In this article, I discuss an academic study that was well done and should be of interest to community bank CEOs. It underscores the importance of the written words "shareholder value."

CEOs, Repeat After Me: My Goal Is Shareholder Value!

Bank CEOs will soon be writing their investor letters for the annual reports, so my article is timely. John Simons of *The Wall Street Journal* (see "The Two Words That Earn CEOs a Pay Raise" in the November 8, 2016, edition) recently summarized the salient conclusions from a scholarly article titled, "Pay for Talk: How the Use of Shareholder-Value Language Affects CEO Compensation." The article was recently published by Taekjin Shin and Jihae You in the peer-reviewed *Journal of Management Studies* (January 2017). While Trump demonstrates the power of the *spoken* word, Shin and You's article reminds us of the power of the *written* word. They found evidence that simply writing the phrase "shareholder value" in investor letters has material impact on CEO compensation.

The first hypothesis that Shin and You tested and found support for is "The expression of shareholder value orientation is positively related to the level of CEO compensation." Given affirmation of this hypothesis, the question that follows is whether the impact is material. We know that executive compensation tends to be very attractive already, so what is the marginal benefit to writing these words? Shin and You's analysis found "that an additional reference to shareholder value [in investor letters] per 1,000 words is associated with an increase in the CEO compensation in the next year by $116,045." That's a pretty good bump in compensation from simply adding those words to the annual report!

Now the astute reader might ask, "Wouldn't a company that's doing well have more of a reason to tout shareholder value?" Then the CEO would be paid better for the fact that the company is doing well, not simply because he included "shareholder value" in the investor letter. True, the whole premise

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that using buzzwords will inflate a salary by more than six figures seems tenuous. However, if you read Shin and You's article, you learn how the professors controlled for firm performance. Moreover, they found that "there seems to be no significant linkage between the use of shareholder-value language and firm performance."

While a CEO does not want activist investors breathing down his neck, the impact on compensation is even greater when activist investors are involved. The second hypothesis tested by Shin and You is whether "the effect of the expression of shareholder value orientation on the level of CEO compensation is stronger when the firm receives a greater number of shareholder resolutions than when it receives a smaller number of shareholder resolutions." These so-called "shareholder resolutions" are those against management. So think of somebody like Bill Ackman of Pershing Square Capital Management who to this day continues to chide the executives and board at Herbalife. While the two professors do not give a specific number in their article, they conclude by saying "being a target of shareholder activism magnifies the effect of the shareholder-value language on CEO compensation." Any CEO who believes his bank is vulnerable to an activist investor should take steps to maximize the intrinsic value of the bank and communicate that goal clearly to stakeholders. This reminds me of the expression "If you're going to talk the talk, you'd better walk the walk," *but in reverse*. If you're going to walk the walk (i.e., strive to maximize shareholder value – which all community banks *should* be doing), then you better talk the talk (i.e., let the world know that this is your top priority!).

Potential Caveats to Shin and You's Research

While this research is intriguing and alludes to the importance of community bank CEOs communicating their goal to grow shareholder value, Shin and You's study was performed using data for *large* U.S. firms. With large firms, there tends to be more asymmetry of information than with smaller firms, where board monitoring is tighter. This means board members at larger firms are not as tuned in to what's going on in the firm as board members at smaller firms; they rely more heavily on publicly available documents, such as annual reports, for their information. In contrast, members of the board of a community bank often have intimate knowledge and a connection to what's happening at the bank. Thus, the $116,000 impact might not be extrapolative to the community bank CEO.

The other extrapolation to guard against is taking this to an extreme. While research might show that a man's health will improve by running a mile a day, that doesn't mean his health will improve even more if he runs 10 miles a day. In fact, he might drop dead if he runs that much! If a CEO intends to increase the number of times he writes the words "shareholder value," he would be wise to not overdo it, as it could begin to sound trite. There obviously is a diminishing return to communicating these words.

The final point to make is that all results from this academic study are based on the past. Just as we say that stock performance in the past does not guarantee the same performance in the future, the impact of communicating the pursuit of shareholder value in future shareholder letters will not necessarily be as lucrative to CEOs going forward. Nevertheless, writing about shareholder value in your year-end letter certainly shouldn't hurt. Shin and You found that "fewer than half of the shareholder letters in the study ever mentioned the principle [of shareholder value]." That's amazing! Yet, the trend is healthy. Simons of *The Wall Street Journal* reports that "In 2005, there were just 616 mentions of 'shareholder value' on corporate earnings calls with analysts and investors; by 2015, that number rose to 3,756 mentions of those buzzwords" (source: Factiva). That trend corresponds to a compound annualized growth rate of nearly 20 percent, so many are recognizing the importance of those words.

As we begin the New Year, in addition to writing about shareholder value, CEOs might want to remind everyone at the bank that without the shareholder, *there is no bank!* That's something you, Donald Trump, and I can all agree on. Best wishes for a successful 2017.

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